SG banks step in where US banks fear to tread

With the recession almost upon us, how is Singapore faring after 3 years of heavy loan making? Well, it's actually not that bad.

Anand Swaminathan, an analyst at investment bank Credit Suisse, noted that though there are talks of a banking sector asset quality stress, things are still manageable as the headline banking system's 28% loan growth is misleading. "The aggregate DBU+ACU system loan growth is a much lower 17% YoY; although this is high by Singapore standards, the gap over nominal GDP growth is not very high compared to history. DBU+ACU loan growth is currently 17% YoY compared to the headline DBU loan growth of 28% YoY," he added.

Macquarie Bank analyst Matthew Smith also noted the strong loan growth based on a sharp rise from corporate loans, but stressed that loan growth will slow in the second half of the year and the final figure will be 19% annualized growth. "While the data is not transparent, discussions with the bankers lead us to believe that roughly one third of loan growth has been USD-denominated RMB trade finance lending. We do not think this will prove to be sustainable in the longer term given funding issues. Specifically, high LDRs of close to 150% at DBS and OCBC should limit the ability to continue such heady growth in the short term as the banks seek medium term financing.

> **DBS profits are impacted by 2.5-3.0%, compared to 2.0-2.5% for UOB/ OCBC.**

In typically conservative management style, UOB has not been willing to become overly leveraged on its USD book, which we think is now at slightly higher than 100%," he added.

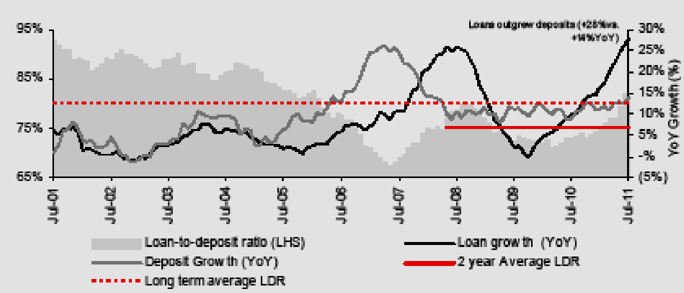
Are Singaporean banks becoming too levered?

Although the spread between system loan growth and GDP growth is near previous cycle highs, it is still below the levels seen in 2006-07. But one worrying sign is that Singaporean banks are at near ten year records of loans to GDP - perhaps caused by more overseas loans. Neverthless it does leave Singapore's banks exposed to credit situations outside of Singapore over which they may have less control. Mr. Swaminathan noted that the main factors contributing to this trend are the increasing pace of inter-ASEAN trade and the drying up of US$ liquidity in the rest of Asia. In essence, with the American banks unable or unwilling to loan more money in Asean, Singapore banks are stepping in and loaning Singapore dollars to companies outside of Singapore.

Are Singapore's three main banks prepared in the face of a potential slowdown?

According to Mr Swaminathan, at least at the outset, UOB has, by far, the most conservative loan growth to potentially risky sectors and has a better cushion from conservative provisioning during the cycle. DBS profits are the most sensitive to rising credit costs among Singapore banks: for every 5 bp rise in credit costs, DBS profits are impacted by 2.5-3.0%, compared to 2.0-2.5% for UOB/ OCBC. But OCBC has the most upside risk and it has also been the least conservative among Singapore banks in boosting coverage levels through general provisioning, he added.

Loans grew by twice the pace of deposits in July, yielding a LDR of 82%



Source: MAS, Macquarie Research, September 2011

Singapore's big three

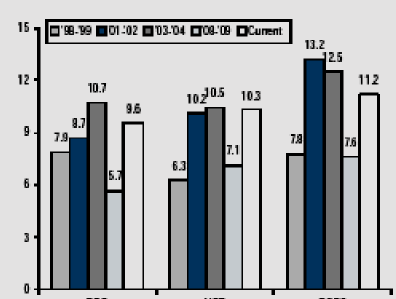
Singapore banks' overseas exposure has always been a key factor during financial crises. Let's check out how the banks are faring recently in terms of their exposure.

DBS: Singapore asset quality worsened during all the past asset quality stress episodes. Hong Kong and ASEAN exposure behaved relatively better during 2008-09, but was offset by worsening asset quality exposure in the 'rest of the world' (mainly Greater China, Europe and the Middle East). While DBS is now more conservative with its 'rest of the world' exposure, the focus this time could be on its exposure in Greater China (in which it has been the most aggressive among Singapore banks) and India (UOB/OCBC have no exposure).

UOB: ASEAN (especially Thailand) exposure has been a key source of concern during previous episodes. This could again be the focus when the current cycle turns as UOB has been actively growing its ASEAN loan book of late.

OCBC: ASEAN exposure has been a key source of concern during previous episodes. Key areas of concern could be its ASEAN and Greater China (OCBC has been aggressively growing its US$ trade finance book) exposure.

12-mth forward P/E (x)—historical crisis lows



Source: Datastream, Credit Suisse estimates